MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2015/2016

BAE2014 – SEMINAR IN ANALYTICAL ECONOMICS

(All section/Group)

3 JUNE 2016
9.00 a.m. – 11.00 a.m.
(2 hours)

INSTRUCTION TO STUDENT

1. This **THREE (3)** pages of question paper consists of **TWO** (2) sections, **SECTION A** and **SECTION B.** Section A consists of **TWO (2) Passage Reviews** and Section B consists of **THREE (3) Structured Questions**.
2. **Answer all questions.**
3. Marks are shown at the end of each question.
4. Write all your answers in the answer booklet provided.

SECTION A: PASSAGE REVIEWS (Total : 40 Marks)

Question One

Read Passage 1 and answer the following questions.

Passage 1

by Balli, Pericoli, & Peirucci, 2016

Empirical literatures have tested the hypothesis of market completeness (full risk sharing), through regression-based tests. Even though this empirical approach was developed through microeconomic applications, the micro-founded macroeconomic model of full international risk sharing has been more extensively investigated as from the contributions by Obstfeld (1986) and Backus and Smith (1993). This can be partly explained with the wider availability of macro data and with the relevance of these analyses in terms of policy implications, especially with regard to international economics, financial integration and financial market regulation.

Asdrubali et al. (1996) introduced the variance decomposition, allowing for testing of the hypothesis of full international risk sharing, along with the evaluation of the extent of effectiveness of the smoothing channels. Within this strand of literature, the focus of the analysis moved to the investigation of the patterns of risk sharing in different regions of the world and to the relative importance of each risk-sharing channel. Therefore, empirical literature has investigated the channels (and their determinants) through which income shocks are absorbed at the macroeconomic level.

There are very few analyses exploring the full risk sharing through which individuals (or households) cope with income shocks, in particular with respect to industrialized countries. There is a lack of contributions at a microeconomic level of analysis of the various channels of income and consumption smoothing, with a particular focus on the functioning of the investment income channel, the fiscal system channel and the savings channel.

The goal of this work is to fill this gap, by empirically 'micro-founding' the variance decomposition developed by Asdrubali et al. (1996), so as to analyse the functioning of the insurance channels at a household level. One of the main advantages of using a microeconomic panel dataset lies in the availability of a very large sample, which allows for evaluating the role and the relevance of the channels by subgroups of individuals. In fact, each channel might function differently with respect to individuals' characteristics, and the detection of relationships between the characteristics of individuals (households) and the role played by each channel might be useful in deriving group-specific policy implications.

We apply the variance decomposition developed by Asdrubali et al. (1996) to sample UK households over a time horizon of more than 10 years (from 1996 to 2007), exploring how households cope with income shocks through each insurance channel. We use the British Household Panel Survey (BHPS) to sample 529 households with a stable structure and always reporting (gross) income, food consumption and other expenditures for durables and non-durables. The large sample size allows us to investigate the role played by individual household's heterogeneity in risk-sharing channels.

Our main findings show that the bulk of the risk sharing is achieved through the savings channel (around 70–80%). By grouping individuals by regions, educational achievement, and risk attitude, it is possible to observe that inflexible savings behaviours are associated with lower degrees of risk sharing via the savings channel. Furthermore, an inverted U-shaped curve exists between risk aversion and the extent of income smoothing achieved through financial markets.

Extracted from Balli, F., Pericoli, F. M., & Peirucci, E. (2016). The title of this journal is not provided due to the nature of the examination question. *International Journal of Finance & Economics, 21*, 90–104.

Continued ...

Review Passage 1 and answer the following questions.

(a) Suggest a suitable topic for Passage 1. (2 marks)

(b) Argue persuasively based on the ***accuracy and precision of factual evidence***, ***completeness of explanation***, and the ***representative*** of the research done. (18 marks)

(Total : 20 marks)

Question Two

Read Passage 2 and answer the following questions.

Passage 2

by Colombo, Onnis, & Tirelli (2016)

Banking crises are typically associated with a prolonged decline in output and employment (Rajan and Zingales, 1998; Cerra and Saxena, 2008). Understanding the shadow economy adjustment to banking crises makes it possible to provide a better estimate of output and employment losses. Although the existence of an informal sector may add resilience to the economy when times are hard, the erosion of the tax base income greatly complicates the task of fiscal policy makers at a time of ballooning public deficits.

There are several approaches for measuring the shadow economy. All of them have shortcomings since the shadow economy is by definition unobservable. Firstly, the Multiple Indicator–Multiple Cause (MIMIC) approach pioneered by Schneider is essentially a structural model where the shadow economy is estimated from a system of equations composed of economic and institutional variables. This approach is most appropriate in identifying the structural long-run relation between the official and the shadow economy. Secondly, the electricity consumption approach takes electricity consumption growth as a proxy for total output growth (both formal and informal). Since data on electricity consumption are quite precise and are available for a large panel of countries, it is an ideal measure for capturing the effect of shocks. Electricity consumption is often used as a leading indicator for business cycle and it is a unlikely to be affected by policy responses to the crises.

We base our shadow economy estimates on the electricity consumption approach and analyze its response to banking crises. In our analysis we investigate whether our proxies for total output growth, i.e. our measures of electricity consumption growth, react to banking crises in a way which is different from that of official output growth. Our methodology for identifying the effects of banking crises follows Cerra and Saxena (2008), who in turn draw on the influential work by Romer and Romer (1989). We estimate the following autoregressive model:

$$Y_{i,t} = \alpha_i + \sum_{\rho=1}^{k} \beta Y_{i,t-\rho} + \sum_{\rho=1}^{k} \gamma DFC_{i,t-\rho} + e_{i,t}$$

where Y = total economic activities, DFC is a dummy variable for the presence of a banking crisis, and i is a country index. The model is estimated also for official GDP growth as a benchmark. The number of lags of both the dependent variable and the crisis dummy have been chosen to maximise the informativeness of the model.

Extracted from Colombo, E., Onnis, L., & Tirelli, P. (2016). The title of this journal is not provided due to the nature of the examination question. *Journal of Banking and Finance*, *62*, 180–190.

Review Passage 2 and answer the following questions.

(a) Discuss the theoretical framework used in Passage 2. (8 marks)

(b) Supposed you replicate the research in Passage 2 and studied on "Shadow Economies at Times of Banking Crises in Malaysia". Write the ***problem statement*** to your study. (8 marks)

(c) Based on your answer in (b), formulate the estimating ***equation*** for your study.(4 marks)

(Total : 20 marks)

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SECTION B: STRUCTURED QUESTIONS (Total : 60 Marks)

Question One

(a) Explain why is literature review necessary in economic research. (6 marks)

(b) Discuss how you use the concept of "writing to learn" when you review a journal article. (6 marks)

(a) What are the characteristics of data sets used in economic research? Explain with appropriate examples. (8 marks)

(Total : 20 marks)

Question Two

(a) Explain with appropriate examples, the types of published academic research. (5 marks)

(b) Discuss how you would evaluate the quality of published research papers. (15 marks)

(Total : 20 marks)

Question Three

Read the ***Abstract*** below and answer the following questions

Abstract
by Huang (2015)

This study investigate whether corruption negatively impacts economic growth in thirteen Asia-Pacific countries over the 1997–2013 period. The empirical results show that there is a significantly positive causality running from corruption to economic growth in South Korea, a significantly positive causality running from economic growth to corruption in China and no significant causality between corruption and economic growth for the remaining countries. According to the empirical results, we do not support the common perception that corruption is bad for economic growth for all thirteen Asia-Pacific. On the contrary, results of this study suggest that the "grease the wheels" hypothesis is supported for South Korea. Additionally, results of this study indicate that for most Asia-Pacific countries, policy makers' use of anti-corruption policies to promote a country's economic development may not be effective. Finally, results of this study also suggest that for China, increase in economic growth leads to an increase in corruption.

Extracted from Huang, C. J. (2015). The title of this journal is not provided due to the nature of the examination question. *North American Journal of Economics and Finance*, *35*(100), 247–256.

Based on the ***Abstract*** above, answer the following questions.

(a) Suggest **2** variables that will be used in the study. Justify your suggestion. (6 marks)

(b) What are the data that can be used to represent (proxy) the variables you suggested in (a)? (4 marks)

(c) Based on your suggestions in (a) and (b), express the econometrics analysis that you will employ to conduct the study. (10 marks)

(Total : 20 marks)

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